Supreme Court of the United States

October Term, 1945.

No. 244

AGNES SCHONGALLA, as Executrix of the Last Will and Testament of WILLIAM SCHONGALLA, Deceased,

Petitioner and Appellant Below,

AGAINST

HARRY M. HICKEY, United States Collector of Internal Revenue, 14th District of New York,

Respondent and Appellee Below.

Petition and Brief for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

EDWARD A. ALEXANDER,
Attorney for Petitioner.

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MAY IT PLEASE THE COURT: The petition of Agnes Schongalla, as Executrix of the Last Will and Testament of William Schongalla, deceased, respectfully shows to this Honorable Court:

Summary Statement of the Matter Involved.

Suit was brought in the United States District Court, Northern District of New York, for the recovery, after payment under protest and rejection of claim for refund, of about $13,780.36 and interest of Federal Estate Taxes assessed by the Bureau of Internal Revenue upon the inclusion in decedent's gross estate of certain life insurance policies payable to beneficiaries other than the Estate, as

to which petitioner claimed that the decedent possessed no incidents of ownership.

The District Court dismissed petitioner's complaint and such dismissal was affirmed by the United States Circuit Court of Appeals for the Second Circuit on May 2, 1945. Three opinions were written; two by the District Court, which heard reargument. The Circuit Court's opinion has not as yet been published in bound-volume but appears on the first page of the New York Law Journal of June 2, 1945. Copy of the opinion is appended to the certified transcript of record submitted herewith. The District Court's opinions appear at pages 81 and 99 of the record.

The case would bring up for review and determination by this Honorable Court the question as to whether, in an ordinary annual-premium life insurance policy by which the insured is given upon issuance thereof, no right to change beneficiary or any other incident of ownership, the incorporation of a provision that if the beneficiary should predecease the insured the latter and his estate shall receive the benefits, renders the proceeds of such policy taxable upon the insured's death even if, as in this case, the beneficiary actually survived (cf. *Helvering* v. *Hallock*, 309 U. S. 106).

The public importance of a correct decision on this point, as well as on the other points in this case, is manifest; the decision of the Circuit Court of Appeals was considered by the New York Law Journal to be of such importance that it was published on the front page for the benefit of the legal profession in its issue of June 2, 1945.

Besides its public and general importance, arising out of the foregoing considerations, the case is of particular importance because the Circuit Court sustained taxation of the life insurance policies in question by recognizing an "inchoate reformation" thereof in order to fix the basis for a tax, and in so doing by-passed the rights of the

beneficiaries, who were infants when the policies were issued, remained infants upon maturing of the policies by the insured's death, and were not parties to the proceedings; nor was the issuer of the policies a party.

* * * * *

William Schongalla died on January 12, 1938 at age 64, leaving him surviving his widow (petitioner), his 85-year-old mother, and two sons, William and Edward, then aged respectively eighteen and nineteen. At his death he left, besides other insurance on his life exceeding the statutory exemption of $40,000 (Sec. 302[g] Revenue Act of 1926) two policies issued by Union Central Life Insurance Company, identical in terms, of which one or the other of his sons was, respectively, the beneficiary. Each policy provided on its face for an endowment of $30,000 payable to the named beneficiary, "his administrators, executors, or assigns", on July 12, 1959, if insured be then living or, on his death before that time, for the payment of $30,000 (in lump sum) to the named beneficiary "his administrators, executors or assigns." Each policy stated on its face: "This policy is without privilege of change of beneficiary", and the date of issuance thereof as May 20, 1924; but at the time of decedent's death had attached thereto a rider in the form of an "Agreement Respecting Payment of Policy", also dated May 20, 1924, to which was subjoined an "acceptance" by the insurance company dated September 8, 1942. Under the terms of the rider the proceeds of the policy involved were made payable, in accordance with a certain settlement, Option No. 3 in the policy, in equal one-third instalments on the beneficiary's attainment of the respective ages of 24 years, of 30 years and of 35 years. Each rider also provided:

> "In the event my said son survives me, but dies before attaining the age of thirty-five years, the

amount due at his death shall be paid to his executors, administrators or assigns.

In the event I survive my said son, said net sum shall be paid to my executors, administrators or assigns."

Each policy provided in the body thereof that the privileges of surrendering the same for cash, converting the same into extended or paid up insurance, and of borrowing thereon, were exercisable by "the owner of the policy". Copies of the policies appear opposite pages 56 and 58 of the record. It may be here stated that both the District Court and the Circuit Court of Appeals conceded that *sans* the riders above mentioned "the owner" of each policy as matter of law would be the beneficiary; the riders alone and the circumstances and validity of their attachment engender the problems involved (pp. 86-87; 152).

The decisions of both lower courts turned upon the issue as to how the riders came to be attached to the policies, *after issuance without right to change beneficiary*, and the legal effect thereof. In connection with that issue, it appears from the facts, which were all stipulated below, (pp. 48 to 79; 92 to 98) that in applying for this insurance and for other coincidental insurance, all of which was to form a "family income or trust plan" the decedent had specified that the policies applied for were to be written without privilege of change of beneficiary; that originally the policies were written and issued without such privilege; that subsequently to their issuance, after request had apparently been made in insured's behalf by the agent of the insurance company upon the company's home office in Cincinnati, Ohio, for incorporation of the above mentioned riders containing the "trust plan" for these policies, and such request had been refused on that ground that: "The desired changes cannot be made * * * for the reason that the beneficiaries under these policies are minor children and

no right is reserved to change the beneficiary", (fol. 281) the agent of the Insurance Company advised its home office, as follows:

> "I have gone over, with Mr. Mabie, the question of the Settlement Option form desired on the 2 above numbered policies. We have discovered that a mistake was made in the application. This insurance is part of the large case written recently and placed by Mr. Mabie and was all sold and accepted on the trust fund plan.
>
> Mr. Mabie worked out a schedule providing for the family of Mr. Schongalla and providing for the establishing of a trust fund and the distribution of the proceeds. He realized that the Company would not issue a policy giving all of the wording in the policy itself and as he had previously done expected to have Settlement Option papers prepared, after policies were issued and accepted. He did not for a moment realize that on the application for these two policies the right was not reserved to change the beneficiary. These policies can not be accepted on their present basis. It is entirely aside from the manner in which the insurance was sold. Mr. Mabie stands ready to make affidavit to that fact. It will knock out entirely the program accepted and furnished for the insured who is now one of the largest policy holders with the Company. These facts are positive and I know them to be the truth.
>
> We know that upon reviewing this situation you will be most happy to prepare papers which you may date the same date as the application for they were as much a part of the original application and desire of the insured as the application itself.
>
> This insurance was applied for by the Corporation of which Mr. Mabie is President and the pre-

miums to be paid by the Corporation" (Letter dated August 18, 1924; pp. 95-96).

In response, the home office referring to the riders, designated as "certificates", wrote to the agent as follows:

> "Enclosed are certificates for the above numbered policies which I trust will be found satisfactory. I understand they are to be completed as of May 20, 1924 and to be considered as part of the application. The original forms must be returned with the duplicates for acceptance by an officer of the Company" (Letter dated August 22, 1924; p. 97).

Thereafter, on or about September 12, 1924, the riders were sent from the company's home office to its agent for delivery to the insured "to be attached to the policies", after having been "accepted" by an officer of the Company (p. 98).

Questions Presented.

Under the above given state of facts two issues were presented to the courts below:

(1) Whether the riders had been properly, legally and effectively attached to the policies, becoming part thereof; if they had not, no tax could accrue.

(2) If they had become parts of the policies, whether by virtue thereof any "incidents of ownership" resided in the decedent at his death to render the policies taxable (pp. 99; 152-153).

On the first issue, the courts below, in substance took the position that an error had been made in the issuance of the policies and that error was attributed to Mr. Mabie, the insurance agent, on the ground that "he knew the

wishes of the insured and chose the procedure to be followed to give effect thereto; he intended to have the insurance contracts prepared and accepted and to then have the same amended by making substantial changes therein"; that the attachment of the riders constituted the "correction of a mistake"; and that the insured had the right, regardless of the original issuance of the policies in a form not according him any such right, to make the alterations in question by way of "correcting" such mistake. The lower court based such "right" on an estoppel raised against the petitioner, the insurance company, and the beneficiaries by reason of their having "accepted" the riders and the terms thereof by acting thereon (pp. 87; 101); the Circuit Court on the insured's unexercised "inchoate" right to reformation, conforming the policies to the "actual" contracts of insurance which the court conceived to have been made *in principio* (pp. 155-158).

While the District Court regarded the "engrafting" of the riders upon the policies as a *de facto* if not *de jure* exercise of dominion over the insurance by the insured and held him therefore to have been recognized by the insurance company and to be recognizable in law as the "owner" of the policies for purposes of surrendering for cash, loan and other privileges of ownership (p. 87, fol. 261; p. 132, fol. 396) and apparently regarded a "transfer" of such ownership to have taken place with a reservation by the insured of a "possibility of reverter" by virtue of the "survivorship clause" contained in the riders, the Circuit Court did not adopt that view in its decision but held squarely that the insurance policies were to be regarded in law was reformed, *to include* the terms contained in the riders and that the inclusion among such terms of the survivorship clause made the policies subject to a "possibility of reverter" and rendered their proceeds taxable within the scope of this Court's decision in *Helvering* v. *Hallock*, 309 U. S. 106 (p. 158). While that case was not

mentioned *eo nomine*, all of the cases cited by the Circuit Court (*Chase National Bank* v. *U. S.*, 116 Fed. [2d] 625; *Commissioner* v. *Washer*, 127 Fed. [2d] 446; *Bailey* v. *U. S.*, 31 Fed. Supp. 778; *Goldstone* v. *U. S.*, 144 Fed. [2d] 373; and *Liebmann* v. *Hassett*, ... Fed. [2d] ....) rest upon that decision.

Statement Disclosing the Basis Upon Which It Is Contended That This Court Has Jurisdiction to Review; and the Reasons Relied on for the Allowance of the Writ.

Petitioner's prayer that this Court's jurisdiction be exercised is based on the following matters mentioned in Rule 38 of this Court:

1. The Circuit Court of Appeals for the Second Circuit has rendered a decision in conflict with decisions of another Circuit Court of Apeals (Eighth Circuit) on the same subject matter (*Walker* v. *U. S.*, 83 Fed. [2nd] 103) (*Helvering* v. *Parker* 84 Fed. [2d] 838) and in conflict with decisions of the Supreme Court (*Bingham* v. *U. S.*, 296 U. S. 211; *Industrial Trust Co.* v. *U. S.*, 296 U. S. 220).

2. It has decided an important question of local law relating to the reformation of contracts and to the necessity of having the parties interested therein before the court, and relating to the alleged ratification by infant beneficiaries of the acts of an insured, in a way in which, petitioner believes, is in conflict with applicable local decisions. (*Steinbach* v. *Prudential*, 172 N. Y. 471.)

3. It has decided an important question of general law, to wit, that in a tax case a contract may be reformed without the parties thereto being represented in the matter in which their rights were involved, in a way in which, we believe, is untenable and in conflict with the weight of authority. (53 C. J. 1003; 1006.)

4. The said Circuit Court of Appeals has decided an important question of federal law which, we believe, has not been but should be settled by this Court as to the taxation of life insurance, involving the interpretation of the statutes relating to Federal Estate Taxes, in a way which, petitioner believes, is in conflict with applicable decisions of this Court; and has so far departed from the usual and accepted course of judicial proceedings, as in sound public policy and justice to call for the exercise by this court of its power of supervision (see pp. 14, 23 post).

* * * * *

At the time of their issuance, on May 20, 1924, the aforementioned insurance policies provided for the payment on the endowment date or on death of the insured as the case might be, of the lump sum of $30,000 to the beneficiary. The insured was given no right to change beneficiary nor any other incidents of ownership. The beneficiaries were, as matter of law, the owners of the policies.

Pennsylvania Company v. *Commissioner of Internal Revenue,* 79 Fed. (2d) 295; certificate denied 296 U. S. 261;
Ruckenstein v. *Metropolitan Life Insurance Co.,* 263 N. Y. 204;
Ryan v. *Rothweiler,* 50 Ohio State, 595;
Morgan v. *Penn Mutual Life Ins. Co.,* 94 Fed. (2d) 129.

The District Court found as fact:

> "The policies were issued in this manner, at the instance of the writing agent of the company, because he realized that the insurance company would not issue a policy containing the language necessary to cover the decedent's 'trust fund plan,' which was known to and well understood by the agent, and it

was purposed and intended to have settlement option papers covering such plan after the policy was issued and accepted, which, in order to express the full intention of the insured, the company's agent knew would require additional agreements relating to the settlement option to be prepared, signed by the insured and accepted by the company, which could only be accomplished legally if the right to change the beneficiary had been reserved. The writing agent of the company knew the wishes of the insured and he chose the procedure to be followed to give effect thereto; he intended to have insurance contracts prepared and delivered, and further intended to amend them by making substantial changes therein. The insured had knowledge of the procedure used, for he was a party to it. *When the policies were issued and delivered, the insured had the option of accepting or rejecting them in their entirety he accepted them.* Each of the policies contained the following provisions:

'33. *Authority.* None of the terms of this policy shall be modified, nor any forfeiture under it waived, save by an agreement in writing, signed by the President, a Vice-President, the Secretary or an Assistant Secretary, whose authority for this shall not be delegated.

34. *Settlement Options.* The owner of this policy, by written notice to the Company at its home office, for which a form will be furnished on request, may elect to have the net sum payable under this policy paid in either of the following ways in lieu of in a single sum:' (pp. 131-2, fols. 392 to 395).

* * * * *

> "After issuance of the policies, and in order to conform them to his wishes and insurance plan, *the decedent, insured, as owner (under paragraph 34)* exercised *his right* to elect a 'Settlement Option' by executing, upon forms furnished by the company for that purpose, an agreement with respect to each policy, * * " (Italics ours.) (p. 132, fol. 396.)

These findings were approved and paraphrased by the Circuit Court; but that Court added thereto the following:

> "Although the Trial Court's findings of fact do not expressly state that the reservation of the privilege to change the beneficiary *was omitted by mistake from the policies as originally issued*, his opinion on reargument shows that 'the erroneous form of the application *may* have been the fault of the writing agent' * * *. Such mistake gave an insured the right to obtain reformation of the policy to conform to the actual contract of insurance." (Italics ours.) (p. 155.)

In making this assumption, and basing thereon its conclusion that the policies ought to be regarded as reformed by reason of mistake, the Circuit Court made no warrantable inference of fact from the trial Court's findings but, on the contrary, disregarded the finding that the insured *had accepted the policies as written.* In the face of that finding, reformation could not possibly have been decreed in a direct suit; much less collaterally.

Avery v. *Equitable,* 117 N. Y. 451.

However, there is nothing in the record to warrant the conclusion that a mutual *mistake of fact* was made in having the policies issued without right to change beneficiary; on the contrary, the insured did on four occasions

evidence his wish to have the policies issued without that right. Thus, in the application for this insurance the following separate statements appear:

5. a beneficiary (~~with privilege to change on written request~~).

6. Have you any present intention of changing the beneficiary or assigning the policy? No.

(See application attached to policy, p. 56.)

Again, and as found by the District Court, the policies were actually issued without right to change beneficiary, were accepted by the insured in that form, and were retained by him for over two months (p. 101, fols. 303-4; p. 131, fols. 393-4). Finally, on executing the riders, the insured did so only after elision of a clause therein reserving the right to change beneficiary, etc., as follows:

> ~~The insured reserves the right, at any time during the continuance of the policy, without the consent of any beneficiary, to revoke this agreement, or to change the beneficiary, or to revoke this election of settlement option, or to exercise every right and receive every benefit reserved by the said policy to the insured or to the owner of the policy during his lifetime, or to agree with the Company to any change in or amendment of the said policy~~. (See riders attached to policies at pp. 56 and 58.)

It is possible, if not even of more compelling cogency under the evidence, that error *of law* was made on the part of the agent in supposing that the policies could be amended despite the failure to reserve the privilege of changing beneficiary. His error may very well have arisen out of misconception of the term "owner" to whom the right to select settlement option was given. The Dis-

trict Court's findings would support such a conclusion; they do not support a conclusion that the policies ought to stand reformed because an error was made in not originally writing them with right to change beneficiary. If the error was of the character suggested, it is clear that no reformation or other relief would have been legally possible.

Dampskibs Aktieselskabet Thor v. *Tropical Fruit Co.*, 281 Fed. 740;
In Re Gordon, 313 Pa. 118, 169 A. 85;
Baird v. *Publishers', etc.*, 199 N. W. 757.

Furthermore, referring to the riders, the District Court said (p. 87, fols. 259-260):

> "Grave doubt may be entertained as to the validity of the agreement."

Error need not, however, rest exclusively upon the illegality of the riders; even if they were effective, taxation was erroneous and unlawful, and insofar as the Revenue Act of 1926 was construed as covering this insurance, the same must be regarded as unconstitutional and violative of Article I, Section 9 of the Constitution of the United States, since it purports on its face (Sec. 302[g]) to levy a direct tax not proportioned, and such levy has in fact been sustained.

Chase National Bank v. *U. S.*, 278 U. S. 237;
Llewelyn v. *Frick*, 268 U. S. 238;
Wyeth v. *Crooks*, 33 Fed. (2d) 1018.

Under the riders all privileges of ownership under the policies during the lifetime of insured and beneficiary were possessed by the beneficiary (*Pennsylvania Co., etc.* v. *Commissioner, supra*) and it was stipulated that only if

the beneficiary should die before the insured the latter and his estate should receive the "net sum" under the policies. The contingency did not occur, and in point of fact the beneficiary did at all times and in completeness own the policies; the insured had nothing at any time but a prospect of becoming the owner. While the Courts below regarded this prospect as a "possibility of reverter" comparison of the facts in this case and in the cases, including *Helvering* v. *Hallock,* 309 U. S. 106, cited by the lower Courts, compels the conclusion that the principle of *Helvering* v. *Hallock* is not applicable and has been unwarrantably extended.

On the question as to whether the mere reservation of a possibility or prospect of ownership on the part of the insured is an "incident of ownership" sufficient to give rise to the tax, the decisions cited by the Circuit Court below in support of its position affirming the proposition have held *Bingham* v. *U. S.,* 296 U. S. 211 and *Industrial Trust Co.* v. *U. S.,* 296 U. S. 220, to have been overruled by *Helvering* v. *Hallock, supra.* This question has not apparently been determined by this Honorable Court. Furthermore, there is conflict among the Circuit Courts in several circuits on this question,

> Cf. *Walker* v. *U. S.,* 83 Fed. (2nd) 103;
> *Helvering* v. *Parker,* 84 Fed. (2nd) 838;
> *Washer* v. *U. S.,* 127 Fed. (2d) 446,

and a lack of unity of understanding as to the bounds of *Helvering* v. *Hallock, supra,* appears to exist among the lower courts for which clarification ought to be had before decisions multiply upon misinterpretation.

* * * * *

Two other policies both issued by Metropolitan Life Insurance Company of relatively less importance were involved in the litigation: The one, a $3,000 policy issued

on October 20, 1903, designating as beneficiary Minna Schongalla, mother of the insured "if living otherwise to the legal representatives of the insured", contained no reservation of right to change beneficiary and specified that the loan and cash surrender value and all other rights under the policy were to be exercised "as the insured *and* assured may elect"; the other, a $112.19 industrial policy issued on April 10, 1892, contained a Facility of Payment clause, but Minna Schongalla, mother of the insured had been designated as beneficiary (pp. 60, 62).

The lower courts sustained the tax with respect to both of these policies, but petitioner claims such taxation to be erroneous on the grounds that both policies had been issued prior to the effective date of the Revenue Act of 1918 first extending the Estate Tax to Life Insurance; that no right to change beneficiary or any right to enjoy benefits under either policy ever resided in the insured; that with respect to the $3,000 policy the privileges of ownership, to be exercised "as the insured *and* assured may elect", were not possessed by the decedent since the consent of the beneficiary was indispensable (*Reinecke* v. *Northern Trust Co.*, 278 U. S. 339; and that by the specification of a named beneficiary the Facility of Payment clause in the $112.19 policy was inoperative, since the beneficiary survived.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket as No. 19627, Agnes Schongalla, as Executrix of the Last Will and Testament of William Schongalla,

deceased, plaintiff-appellant, against Harry M. Hickey, United States Collector of Internal Revenue, Fourteenth District of New York, defendant-appellee; that the judgment of said Circuit Court in said case be reversed by this Honorable Court, and that your petitioner may have such other and further relief as may be just and proper; and your petitioner will ever pray.

AGNES SCHONGALLA,
Petitioner.

EDWARD A. ALEXANDER,
Counsel for Petitioner.